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No. 88-579

Supreme Court, U.S.
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In The
# Supreme Court of the United States
October Term, 1988

—o—

ONEIDA MOTOR FREIGHT, INC., a corporation organized under the laws of the State of New York,

*Petitioner,*

vs.

UNITED JERSEY BANK, A New Jersey Corporation,

*Respondent.*

—o—

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

—o—

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## QUESTIONS PRESENTED FOR REVIEW

I. Should an action for unliquidated damages instituted on behalf of a Chapter 11 debtor and its general creditors be barred because express reference to such potential claim was not included in the debtor's Schedule of Financial Affairs and Disclosure Statement filed in accordance with sections 521 and 1125 of the United States Bankruptcy Code? Does not such a bar violate the purposes of sections 521 and 1125, and of the Bankruptcy Code as a whole, to protect creditors?

II. Do not section 1125(a) of the United States Bankruptcy Code and Congressional intent, as expressed in the legislative history of that section, necessitate a factual record of competent evidence in order for a Court to determine whether a debtor has provided "adequate information" in its disclosure statement for purposes of a reorganization proceeding under Chapter 11 of the United States Bankruptcy Code?

III. Did the Court of Appeals depart from the usual and accepted course of judicial proceedings in regard to motions under Rule 12(b), 12(c), and 56 of the Federal Rules of Civil Procedure by making assumptions of fact not of record on critical factual issues and using those assumptions of fact to determine that the movant was entitled to judgment as a matter of law?

## LIST OF PARTIES

The parties named in the caption of the case in this Court are all the parties that were involved in the proceeding in the Court whose judgment is sought to be reviewed.

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The petitioner Oneida Motor Freight, Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit, entered in the above-entitled proceeding on May 31, 1988.

## CITATIONS OF REPORTED AND UNREPORTED OPINIONS

The opinion of the United States Court of Appeals for the Third Circuit is reported at 848 F. 2d 414 (1988), with the dissenting opinion of Judge Stapleton commencing at 848 F. 2d 420. The opinion of the United States District Court for the District of New Jersey in *Oneida Motor Freight v. United Jersey Bank,* Civil Action No. 87-1440 (July 6, 1987) is unreported. The opinion is set forth in the Appendix hereto at App. 26.

## STATEMENT OF JURISDICTION

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. section 1254(1) by the filing of a petition for *certiorari* by a party to a civil action in the United States Court of Appeals. The opinion of the Court of Appeals was filed on May 31, 1988. A timely-filed petition for rehearing was denied by the Court of Appeals on July 1, 1988.

## CITATION AND TEXT OF STATUTES AND RULES INVOLVED

*11 U.S.C. Section 521(1):*

521. Debtor's duties. The debtor shall—

(1) file a list of creditors, and unless the court orders otherwise, a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs;

*11 U.S.C. Section 1125(a) and (b):*

1125. Postpetition disclosure and solicitation.

(a) In this section—

(1) "adequate information" means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan; and

(2) "investor typical of holders of claims or interests of the relevant class" means investor having—

(A) a claim or interest of the relevant class;

(B) such a relationship with the debtor as the holders of other claims or interests of such class generally have; and

(C) such ability to obtain such information from sources other than the disclosure required by this section as holders of claims or interest in such class generally have.

(b) An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information. The court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets.

*Federal Rules of Civil Procedure, Rule 12(b) and (c):*

Rule 12. Defenses and Objections—When and How Presented—By Pleading or Motion—Motion for Judgment on Pleadings.

(b) How Presented. Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, crossclaim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over

the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, he may assert at the trial any defense in law or fact to that claim for relief. If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

(c) Motion for Judgment on the Pleadings. After the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings. If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

*Federal Rules of Civil Procedure, Rule 56(c):*

Rule 56. Summary Judgment.

(c) Motion and Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is

entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

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## STATEMENT OF THE CASE

Prior to July 10, 1985, Petitioner was engaged in the interstate and intrastate movement of general commodities as a certified common carrier. As of March 31, 1985, Petitioner had assets of $21.5 million and liabilities of $16.5 million.

Petitioner had entered into banking relations with Respondent in 1982. In 1984, Petitioner entered into a Revolving Credit Agreement with Respondent pursuant to which Respondent agreed to extend credit to Petitioner through loans and letters of credit up to an aggregate amount of $5,000,000.00. At the same time, Petitioner entered into an Accounts Receivable Loan and Security Agreement with Respondent, which provided that Respondent would lend funds based on a designated percentage of Petitioner's qualified accounts receivable and that Respondent would receive an assignment of such accounts receivable as collateral. Respondent also held security interests in nearly all Petitioner's assets as collateral for loans to be made and letters of credit to be issued. At no time were the lending limits of either of the agreements between Petitioner and Respondent reached or exceeded.

Petitioner had acquired the operating rights and assets of Dorn's Transportation, Inc., in 1981. The purchase price for the acquisition was payable over a period of years. A dispute arose between Petitioner and Walter Dorn regarding the payment of the balance of the purchase price, and the parties agreed to secure the amount in dispute by the issuance of letters of credit by Respondent.

In February 1985, the dispute was settled, and Respondent was called upon by Petitioner to pay $920,000.00

to Dorn. Rather than paying in accordance with the terms of the Letters of Credit, as had been previously agreed, however, without authority from or prior notice to Petitioner, Respondent withdrew $450,000.00 from Petitioner's bank account in partial payment to Dorn. This action was taken despite the collateral given to Respondent with a value that greatly exceeded the amount of Respondent's outstanding loans to Petitioner. As a result of Respondent's wrongful act, Petitioner's bank account became habitually overdrawn.

Petitioner complained to Respondent regarding the above-described unauthorized withdrawal from Petitioner's account, and Respondent assured Petitioner that Respondent would continue to honor Petitioner's checks. Petitioner therefore continued its relationship with Respondent as its principal bank, and Respondent did honor Petitioner's checks for several months. On or about July 2, 1985, however, Respondent requested Petitioner's sole stockholder, Donald T. Singleton, to personally guarantee Petitioner's debt. Singleton refused. Thereafter, Respondent requested Petitioner to provide cash-flow projections. Petitioner informed Respondent that it would require approximately two weeks to provide such projections. Respondent advised Petitioner that such a timetable was satisfactory.

Immediately prior to the Fourth of July holiday weekend in 1985, Petitioner issued to its creditors and employees checks in an amount of approximately $1,000,000.00 in the ordinary course of business. On July 5, 1985, three days after Respondent advised Petitioner that it would await the cash-flow projections it had requested, Respondent ceased honoring Petitioner's checks without notice to Petitioner. On July 8, 1985, Respondent told Singleton that if he would now give a personal guarantee of Petitioner's debt, Respondent would advise the payees of Petitioner's checks that the checks had been dishonored as a result of bank error and would direct the payees to pre-

sent the checks again for payment. Singleton refused that proposal.

As a result of Respondent's prior representations and assurances, and its perfidious failure and refusal to notify Petitioner that it would cease honoring Petitioner's checks, Petitioner did not have the opportunity to seek alternative financing. In addition, said actions by Respondent destroyed Petitioner's reputation with its customers and creditors. As a result of the improper acts of Respondent, Petitioner was compelled to file a Petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. Sec. 1101 *et seq.*, on July 10, 1985.

In order to collect accounts receivable and sell assets in an orderly fashion, Petitioner required post-petition financing. Therefore, Petitioner applied, on an emergency basis, to the Bankruptcy Court for use of cash collateral of Respondent. On July 11, 1985, Respondent filed an "application for relief from the automatic stay; to enforce security interests; to appoint a trustee; and in the alternative for conversion or dismissal of the Chapter 11 case." In addition, Respondent objected to use of its cash collateral by Petitioner. Both applications were "contested matters" instituted by notice of motion as provided for in Bankruptcy Rule 9014.

On July 25, 1985, the Bankruptcy Court, after a hearing which had commenced on July 12, allowed Petitioner to use cash collateral up to a limit of $1.5 million. In return, Respondent was given, as additional collateral, liens on unencumbered assets to the extent of cash collateral used.

On December 9, 1985, after all Petitioner's Debtor-in-Possession checks had cleared and service charges had been paid, Petitioner wrote to Respondent to request a payment to close the cash collateral account. A dispute then arose as to additional service charges that Respondent had subtracted from the balance in the account. There was correspondence between counsel for Petitioner and Respondent in regard to this dispute.

Ultimately, Respondent agreed to refund the service charges. However, a form of order submitted by counsel for Respondent as to the service charge issue included a paragraph purporting to release Respondent from *all* claims Petitioner had against it. On February 3, 1986, Petitioner's counsel advised counsel for Respondent that Petitioner objected to the inclusion of language constituting a general release in the proposed Order. On March 3, 1986, an order without a general release was entered by the Bankruptcy Court.

As early as October 1985 (just three months after the filing of the Chapter 11 Petition), Respondent was paid the full amount of its secured indebtedness, a sum in excess of $7,600,000. On June 9, 1986, Respondent filed a proof of claim in Petitioner's bankruptcy proceeding relating to attorney's fees and interest in the approximate amount of $277,000. Petitioner has challenged that claim.

Petitioner and its Creditors Committee jointly prepared a proposed Plan of Reorganization and a Disclosure Statement pursuant to 11 U.S.C. section 1125. Respondent was therein designated a creditor of a class different from the general unsecured creditors. Respondent was the only creditor in that class of creditors.

Petitioner filed its Disclosure Statement with the Bankruptcy Court in the Spring of 1986. Among other things, the Disclosure Statement made reference to the money owed by Petitioner to Dorn that was secured by Letters of Credit issued by Respondent. The Disclosure Statement went on to say that when Respondent was called upon to pay the Letters of Credit, "rather than paying both Letters of Credit and increasing its outstanding loans with the Debtor, which were secured by accounts receivable and certain revenue equipment, the Bank unilaterally withdrew Four Hundred Fifty Thousand Dollars ($450,000) from the Debtor's operating account to be applied towards satisfaction of the Dorn's settlement. Said withdrawal caused an immediate overdraft in the Debtor's ac-

count, which became a chronic situation until the filing of the bankruptcy proceedings in July, 1985."

The disclosure statement then added:

"As stated above, when the bank withdrew Four Hundred Fifty Thousand Dollars ($450,000) in February, 1985, to fund the settlement with Dorn's Transportation, Inc., the Debtor's account became habitually overdrawn or funded substantially with uncollected funds.

"On July 5, 1985, without notice to the Debtor, the bank ceased honoring checks on uncollected or overdrawn funds and returned unpaid the Debtor's July 3, 1985 payroll checks as well as other checks which were being presented to it on an ongoing basis.

"By virtue of the bank's refusal to finance the Debtor, the Debtor had no alternative but to file the Chapter 11 proceedings on July 10, 1985."

Included as an appendix to the Oneida Disclosure Statement was the amended Joint Plan of Reorganization in Oneida's bankruptcy case. Article XII of the Plan of Reorganization provided: "All claims and causes of action in favor of the Debtor and Debtor-in-Possession not expressly released or terminated in accordance with the Plan are hereby preserved and may be prosecuted by the Debtor or the Creditors' Committee after entry of the Confirmation Order."

Petitioner never expressly released its claims or causes of action against Respondent. In fact, Petitioner had expressly refused to give Respondent a general release.

Respondent neither voted in favor of, nor objected to, confirmation of the Amended Joint Plan of Reorganization. The Plan was confirmed by order of the Bankruptcy Court on August 14, 1986.

Petitioner commenced the present action against Respondent on March 11, 1987 in the Superior Court of New Jersey. Petitioner asserted claims against Respondent for breach of the credit and loan agreements, breach of a

course of dealing, breach of the duty of good faith arising from Respondent's banking practices, and fraud. On March 30, 1987, the United States Bankruptcy Court for the District of New Jersey entered an order allowing an amendment to the Reorganization Plan, providing that the creditors of Petitioner would share in any damages award against Respondent in the aforesaid action.

Respondent answered the Complaint on April 15, 1987. Respondent removed the action to the United States District Court for the District of New Jersey on April 20, 1987, pursuant to 28 U.S.C. section 1334(b), on the ground that Petitioner was a debtor in a case under Title 11 of the United States Code. On May 14, 1987, Respondent moved to dismiss the Complaint pursuant to Rules 12(b)(6) and Rule 12(c) of the Federal Rules of Civil Procedure. On July 6, 1987, the District Court entered an Order dismissing the Complaint on grounds of *res judicata,* holding that the claims asserted in the Complaint should have been raised by Petitioner during the course of its bankruptcy case. Oneida filed a Notice of Appeal from said Order on July 31, 1987. On May 31, 1988, the United States Court of Appeals for the Third Circuit, with one judge dissenting, filed an opinion affirming the decision of the District Court on the different ground that Petitioner was estopped from asserting the claims in its Complaint because Petitioner had not disclosed those claims during the course of its bankruptcy case. A petition for rehearing was denied by the Court of Appeals on July 1, 1988.

## REASONS FOR ALLOWANCE OF THE WRIT

This Case Presents Important Questions of Federal Bankruptcy Law That the Supreme Court Has Not Decided and Should Decide, and That the Court of Appeals for the Third Circuit Decided Contrary to the Spirit and Purpose of the Bankruptcy Code and the Decisions of Other Circuit Courts.

**I. The Fundamental Purposes of the United States Bankruptcy Code to Protect Creditors and Rehabilitate Debtors in Chapter 11 Bankruptcy Proceedings Are Plainly Contravened by the Decision of the Court of Appeals that Petitioner Is Barred from Maintaining this Action Against Responent Because this Unliquidated Claim Was Not "Announced" by Petitioner During Its Bankruptcy Case.**

In its Complaint filed against Respondent on March 11, 1987, Petitioner alleged that Respondent had breached its lending agreements and course of dealing with Petitioner and its duty of good faith to Petitioner, and had perpetrated a fraud upon Petitioner. Petitioner further alleged that Respondent's wrongdoing caused Petitioner to file a petition under Chapter 11 of the Bankruptcy Code, to terminate its operations, and to suffer a complete loss of its business. The Amended Joint Plan of Reorganization of Petitioner and its Creditors Committee provides that Petitioner's general unsecured creditors would share in the proceeds of Petitioner's recovery, if any, from Respondent in this action.

Respondent moved to dismiss Petitioner's claim pursuant to Rules 12(b)(6) and 12(c) of the Federal Rules of Civil Procedure on grounds that Petitioner's bankruptcy case precluded maintenance of this action. The District Court granted Respondent's motion, and dismissal of the Complaint was affirmed by the Court of Appeals for the Third Circuit.

The Third Circuit held, among other things, that "[Petitioner]'s failure to announce this claim against [Respondent] precludes it from litigating the cause of action at this time."* *Oneida Motor Freight v. United Jersey Bank,* 848 F.2d 414, 418 (3d Cir. 1988). The Third Cir-

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* Petitioner disputes the Third Circuit's conclusion that Petitioner failed to announce its claim against Respondent, and that dispute is discussed in Points II and III, *infra*.

cuit's holding thus amounts to a declaration that, as a matter of law, a debtor in a proceeding under Chapter 11 of the Bankruptcy Code that does not disclose during its bankruptcy proceedings the existence of an *unliquidated* claim it might have against a secured creditor is thereafter barred from asserting that claim in a separate lawsuit. Petitioner submits that the holding of the court below is not in accord with any provision of the United States Bankruptcy Code of 1978 and 1984, 11 U.S.C. section 101 *et seq.;* is contrary to the underlying purpose of the Bankruptcy Code; and conflicts with a recent decision of the Court of Appeals for the Fifth Circuit and other federal caselaw. The Third Circuit's decision, if undisturbed by this Court, will have far-reaching, deleterious effects on debtors and creditors in Chapter 11 bankruptcy proceedings.

The primary purpose of the Bankruptcy Code is to facilitate the rehabilitation of debtors, while at the same time ensuring fair and equitable treatment of all the creditors of the debtor. Inasmuch as the Third Circuit's decision would foster obstruction of the rehabilitation of debtors and would diminish the extent of payment to creditors, it is contrary to the primary purpose of the Bankruptcy Code. Furthermore, the decision would permit, in the words of the dissenting opinion below, a "windfall" to a wrongdoer—in this case a secured creditor that had been paid in full—to the detriment of the debtor and its unsecured creditors. (App. 16)

In ruling that Petitioner had wrongfully failed "to announce" its claim against Respondent, the majority of the court below relied specifically upon two sections of the United States Bankruptcy Code: section 521(1) and section 1125.

Section 521(1) provides that a debtor must "file a . . . schedule of assets and liabilities . . . and a statement of the debtor's financial affairs." 11 U.S.C. sec. 521(1). The

majority noted that in the schedules it filed pursuant to section 521(1), Petitioner set forth a debt of approximately $7.7 million to Respondent, but made no mention of any claim *against* Respondent. The majority employed the silence of Petitioner's schedules as a basis for affirming the dismissal of Petitioner's Complaint in the instant matter. Petitioner submits that the underlying purposes of section 521, in conjunction with the purposes of the Bankruptcy Code as a whole, are undermined by the decision of the Third Circuit.

The general purpose of requiring a debtor to file a schedule of its creditors and liabilities is to enable creditors to receive timely notice of bankruptcy proceedings that may affect their interests. *Ford Motor Credit Co. v. Weaver,* 680 F.2d 451, 456 (6th Cir. 1982). A debtor will not be discharged from its debt to a creditor who was omitted from a schedule filed by the debtor pursuant to section 521(1). 11 U.S.C. sec. 523(a)(3). The general purpose of requiring a debtor to file a statement of financial affairs is to furnish the creditors with detailed information concerning the debtor's financial condition without requiring a long and protracted examination to obtain such information. *United States v. Stone,* 282 F.2d 547 (2d Cir. 1960); 3 *Collier on Bankruptcy,* paragraph 521.09 at 521-36 to 521-37 (15th ed. 1988).

Clearly, therefore, the purpose of section 521(1) is to obligate the debtor to make disclosures for the benefit of creditors.

When Petitioner filed its schedules, it did not mention therein a potential unliquidated lender liability claim against Respondent. However, the absence of that claim from the schedules had no adverse effect on fulfillment of the purposes of section 521(1). It did not prevent any creditor from receiving notice of the bankruptcy proceeding, nor did it detract from the detailed financial information provided by Petitioner to its creditors. While absence of a potential asset from Petitioner's schedules could have

been grounds for revocation of the discharge received by Petitioner had it been tantamount to a fraudulent concealment, 11 U.S.C. secs. 727(d) and 1141(d), in this case Petitioner and its Creditors Committee have provided in their Amended Joint Plan of Reorganization that Petitioner's general creditors would share in the proceeds, if any, from the prosecution of the claim. The dismissal of the claim is therefore detrimental not only to Petitioner, but also to Petitioner's creditors. Petitioner submits that it is truly incongruous for the Third Circuit to utilize a provision of the Bankruptcy Code intended to benefit creditors to do those creditors such an injustice. (See dissenting opinion of Judge Stapleton at App. 21.)

For the same reason, the Third Circuit's reliance on section 1125 of the Bankruptcy Code to affirm dismissal of Petitioner's Complaint must be reviewed. Section 1125 (b) of the Code provides that a debtor under Chapter 11 must file a disclosure statement before it can solicit creditors to accept a plan of reorganization. The majority opinion below, citing 5 *Collier on Bankruptcy* paragraph 1125.03 (15th ed. 1988), referred to the disclosure statement as the "pivotal concept in reorganization procedure under the Code."

The primary purpose of this "pivotal concept" has been described as "provid[ing] all material information which creditors . . . affected by the plan need in order to make an intelligent decision whether to vote for or against the plan." *In re Unichem Corp.*, 72 B.R. 95, 97 (Bkrtcy. N.D. Ill. 1987). Similarly, in *In re Brandon Mill Farms, Ltd.*, 37 B.R. 190, 192 (Bkrtcy. N.D. Ga. 1984), the court stated that the disclosure statement is intended to assist the creditors in evaluating the plan on its face. Furthermore, in *In re Stanley Hotel,* 13 B.R. 926, 929 (Bkrtcy. D. Colo. 1981), the court held that the disclosure statement is supposed to inform claimants "as fully as possible, about the probable financial results of acceptance or rejection of a particular plan."

The common theme running through the above cases is that the disclosure statement is for the benefit of creditors, to help them assess a proposed reorganization plan and decide whether to vote in favor of that plan.

The Third Circuit relied on the silence of Petitioner's Disclosure Statement regarding a possible claim against Respondent to affirm dismissal of Petitioner's Complaint against Respondent. In so doing, the court below once again employed, to the detriment of Petitioner's creditors, a statutory provision designed to benefit those creditors. The majority opinion creates a rule of law that a debtor's failure "to announce" in its Disclosure Statement the existence of a possible claim against a secured creditor bars the debtor from thereafter asserting such a claim. The effect of such a rule of law is to give a windfall to a wrongdoer at the expense of both the debtor seeking rehabilitation and the innocent creditors seeking fair and equitable treatment. (See dissenting opinion of Judge Stapleton at App. 21.) The Third Circuit's decision thus clearly violates the primary purposes of the Bankruptcy Code.

The fallacy of the Third Circuit decision is made obvious by an analysis of the situation. The Petitioner submitted a Disclosure Statement that was approved by the bankruptcy court as containing "adequate information" as defined by 11 U.S.C. section 1125(a); the Disclosure Statement indicated that the Petitioner would be able to make a plan of reorganization that would provide for payment of approximately 25 to 30 cents on the dollar to general unsecured creditors, depending on the amount of allowed unsecured claims; the creditors found the proposed plan to be acceptable and voted to approve the plan; the creditors' acceptance of the proposed plan was solicited and obtained without reference to the possibility of an unliquidated claim against Respondent that would have no positive impact on the Plan of Reorganization unless successful, but could increase the dividend to creditors

to some extent if it were successful. Petitioner submits that the Third Circuit's use of section 1125 (which was intended to benefit creditors) to the detriment of the creditors and Petitioner because Petitioner did not tell the creditors that Petitioner *might* be able to pay its creditors some *indeterminable* additional amount at some *unforeseeable* date in the future is unfair and contrary to the purposes of the Bankruptcy Code.

It is also at odds with the very recent decision of the Fifth Circuit Court of Appeals in *Matter of Texas Extrusion Corp.*, 844 F.2d 1144 (1988). In that case, the Fifth Circuit noted that "the determination of what is adequate information is subjective and made on a case by case basis," and is a decision "largely within the discretion of the bankruptcy court." 844 F.2d at 1157. The Fifth Circuit was addressing the question whether the debtor's failure to reveal in its disclosure statement that it was contemplating seeking equitable subordination of the claims of its largest creditor rendered the information in the statement inadequate. (Equitable subordination is a procedure pursuant to which the bankruptcy court can order a particular creditor's claim to be paid *after* instead of before the claims of other creditors. 3 *Collier on Bankruptcy, supra,* para. 510.02. This can enhance the recovery of those other creditors, particularly if the subordinated creditor has a sizeable claim.) The Court answered the question in the negative, holding that conjecture that the creditor's claims might be subject to equitable subordination "is not the type of information that is required in a disclosure statement to provide 'adequate information' to a creditor." *Ibid.*

Petitioner respectfully submits that the principle expressed by the Fifth Circuit in *Matter of Texas Extrusion Corp.* should apply here. The possibility that Petitioner might assert an unliquidated claim against a secured creditor is not the type of information that is required in a disclosure statement to provide ade-

quate information. At the time the statement was prepared, it was merely conjecture whether that claim would in any way enhance the debtor's estate for the benefit of creditors. Disclosure of such uncertainty ought not to be considered necessary to provide adequate information, since it would not have enhanced the ability of creditors to make an informed judgment about a proposed plan of reorganization and was not essential to the success or failure of the plan, which the creditors approved anyway.

Similarly, in *In re Werth,* 29 B.R. 220 (Bankruptcy D. Colo. 1983), the court held that a debtor did not have to reveal in its disclosure statement what claims of creditors it intended to challenge and why. The court's reasoning in *Werth* is also applicable in the present matter: "In my judgment, the objections to claims do not bear on the success or failure of the plan in this case. . . . The value of the estate as presently reported in the disclosure statement is at its minimum, and any successful objections to claims will serve to increase the assets of the estate for the benefit of creditors. The informed choice of the creditors will not be enhanced because of the uncertainties as to which claims will be disputed as well as the uncertainties of the outcome of these proceedings." 29 B.R. at 223. *Accord In re J.E. Jennings, Inc.,* 46 B.R. 167, 172 (Bankruptcy E.D. Pa. 1985) (no need to disclose intended preference actions).

For the same reasons, failure to disclose the possible claim against Respondent in the disclosure statement should not bar Petitioner from maintaining this lawsuit against Respondent. This is particularly so where, as here, the Petitioner's plan of reorganization: has preserved for post-confirmation prosecution any claims not expressly released by Petitioner; and has provided for retention of jurisdiction by the bankruptcy court in the event of assertion of claims that would enhance the debtor's estate. *See In re J.E. Jennings, Inc., supra,* 46 B.R. at 170; *In re Air One, Inc.,* 75 B.R. 998, 1002 (Bankruptcy E.D. Mo. 1987).

Furthermore, as pointed out by Judge Stapleton in his dissenting opinion in the Court below, the absence of specific reference to the claim against Respondent in Petitioner's disclosure statement did not in any way harm Petitioner's creditors, who approved Petitioner's Plan of Reorganization. On the other hand, dismissal of Petitioner's lawsuit against Respondent *does* harm the creditors, by denying them potential recovery of additional funds if the action is successful. Thus, the purposes of the Bankruptcy Code are carried out by continuation, not dismissal, of this action. *Cf. In re J.E. Jennings, Inc., supra,* 46 B.R. at 171.

In essence, Petitioner submits, the decision of the Court of Appeals for the Third Circuit establishes a rule of law that will wrongly penalize a debtor and its creditors if the debtor does not disclose claims involving truly uncertain recoveries in soliciting acceptances of a plan of reorganization from the creditors.

In deciding that Petitioner's "failure to announce" its claim against Respondent precludes Petitioner from now maintaining an action against Respondent, the Third Circuit also noted that Petitioner could have raised its claim against Respondent at the time Respondent moved to vacate the automatic stay in Petitioner's bankruptcy case,* or at the hearing on Petitioner's application to use cash collateral. However, the hearing of both Respondent's motion and Petitioner's application was held on July 12, 1985, just two days after Petitioner commenced its case under Chapter 11. Petitioner was then attempting to salvage its business of 50 years despite Respondent's actions, and was not in a position to consider counterclaims or affirmative defenses. Furthermore, the Third Circuit,

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* The majority opinion did concede that from a procedural standpoint and from a practical standpoint Petitioner could not litigate its claims against Respondent as a counterclaim to the motion to vacate the stay, but concluded that Petitioner should have at least mentioned its claims at that time for the consideration of the bankruptcy court.

affirming a decision on a motion pursuant to Rule 12(b)(6) or 12(c) of the Federal Rules of Civil Procedure and thus lacking a full evidential record, could not have known what was or was not mentioned at that hearing. Moreover, regardless of whether or not any mention was made by Petitioner of a potential claim, Respondent was aware of its wrongful conduct. Respondent, a tortfeasor, should not be excused from its conscious wrongdoing because its victim failed to mention a possible claim against it.

Even disregarding the faulty logic of the majority of the court below, however, Petitioner submits that the United States Bankruptcy Code, and the purposes the Code seeks to carry out, are contravened by the suggestion that if a debtor does not mention a possible claim against one of its creditors as early as two days after commencement of its bankruptcy case, the debtor can lose its right to pursue that claim. Such a result is incompatible with the concept of a "fresh start" for the debtor and fair and equitable treatment for all creditors.

The decision of the Third Circuit also undermines the purposes of the Bankruptcy Code to allow for speedy, simple, and expeditious resolution of bankruptcy cases. Speed and simplicity are important to both debtors and creditors, as they enable prompt distribution to creditors on their claims, reduce administrative expenses to debtors, and increase the ultimate recovery by creditors by minimizing the adverse effects of attempting to operate for an extended time under the protection of federal bankruptcy laws. 5 *Collier on Bankruptcy,* para. 1125.02 at 1125-10 (15th ed. 1988). The Third Circuit decision establishes a rule of law that will interfere with the speed and simplicity of bankruptcy proceedings and will impede the accomplishment of the Code's purposes. The Third Circuit holds that a debtor must mention, during its bankruptcy proceedings, a possible claim it might have against a secured creditor. The majority of the court stopped short of specifically requiring a debtor to *litigate* its possible claim

against its secured creditor in bankruptcy court. However, this Court must recognize that in most cases, if a debtor is required to mention a potential claim against a secured creditor, litigation of that claim will surely result, either in the bankruptcy court itself or in another court while the bankruptcy case is pending. If the possible claim is in any way substantial or complicated, the requirement that the debtor mention such claim in its bankruptcy case is extremely likely to defeat the simplicity and expeditiousness of bankruptcy proceedings, to the detriment of both the debtor and its creditors.

It is submitted that the Third Circuit's decision that Petitioner's failure to mention its possible claim against Respondent bars Petitioner from maintaining this lawsuit is not warranted by the Bankruptcy Code, and is contrary to the purposes of the Code to assist debtors and creditors and to expedite bankruptcy cases.

It is submitted further that the intervention of this Court is necessary to prevent the undermining of the fundamental purpose of sections 521 and 1125, and of the entire Bankruptcy Code, particularly where it would result in a windfall to one tortfeasor-creditor. Such intervention is necessary in order that results that are just and fair to all parties be achieved, as intended by Congress.

**II. The Provisions of The Bankruptcy Code Regarding Disclosure Statements and the Legislative History of Those Provisions Are Plainly Contravened by the Third Circuit's Legal Conclusion That Petitioner's Disclosures Were Informationally Deficient.***

The majority of the court below ruled that Petitioner is barred from maintaining its lawsuit against Respondent

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* In Point I, *supra,* Petitioner challenges the Third Circuit's decision that Petitioner's failure to announce its claim against Respondent bars litigation of that claim. In this Point, Petitioner submits that even the Third Circuit's determination that Petitioner failed to announce its claim against Respondent clearly contravenes the provisions and purposes of the Bankruptcy Code.

because Petitioner "failed to announce" its claim against Respondent during the course of its bankruptcy case. In making that decision, the majority necessarily first reached the conclusion that Petitioner had "failed to announce" its claim against Respondent. That conclusion is, however, contrary to section 1125(a) of the United States Bankruptcy Code, 11 U.S.C. sec. 1125(a), and to the legislative history and interpretive caselaw regarding that section.

The Third Circuit called the duty of a debtor to file a disclosure statement containing "adequate information" a duty of paramount importance "in the reorganization of a Chapter XI [*sic*] debtor." The Third Circuit proceeded to give lip service to the legislative history of section 1125, stating "adequate information will be determined by the facts and circumstances of each case. H.R. Rep. No. 595, 97th [*sic*] Cong., 1st Sess. 266 (1977)." (App. 8) However, in reality the Court gave no consideration to the facts and circumstances of the case. Indeed, Respondent moved to dismiss Petitioner's Complaint pursuant to Rule 12(b)(6) or 12(c) of the Federal Rules of Civil Procedure, and no factual record of any significance was before the Court. Instead, the Third Circuit simply concluded that Petitioner had failed to mention the potential claim against Respondent and thus had failed to provide adequate information.

The Third Circuit's conclusion is clearly an unreasoned, erroneous conclusion that disregards, and radically departs from, the provisions of the Bankruptcy Code that it purports to uphold and the Congressional intent behind those provisions, as expressed in the legislative history.

House of Representatives Report 95-595 described the requirement of disclosure of adequate information as set forth in section 1125 of the Bankruptcy Code as follows:

> "Subsection (a) contains two definitions. First, 'adequate information' is defined to mean information of a kind, and insufficient [sic] detail, that would en-

able a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan. Second, 'investor typical of holders of claims or interests of the relevant class' is defined to mean an investor having a claim or interest of the relevant class, having such a relationship with the debtor as the holders of other claims or interests of the relevant class have, and having such ability to obtain information from sources other than the disclosure statement as holders of claims or interests of the relevant class have. . . .

"The Supreme Court's rulemaking power will not extend to rule-making that will prescribe what constitutes adequate information. That standard is a substantive standard. *Precisely what constitutes adequate information in any particular instance will develop on a case-by-case basis. Courts will take a practical approach as to what is necessary under the circumstances of each case.* . . . There will be a balancing of interests in each case. In reorganization cases, there is frequently great uncertainty. Therefore the need for flexibility is greatest. . . . The court will be able to determine what is necessary in light of the facts and circumstances of each particular case." H.R. Rep. No. 595, 95th Cong., 1st Sess. 408-409 (1977) (emphasis added).

Senate Report 95-989 added, in pertinent part, the following:

"Both the kind and form of information are left essentially to the judicial discretion of the court, guided by the specification in subparagraph (a)(1) that it be of a kind and in sufficient detail that a reasonable and typical investor can make an informed judgment about the plan. The information required will necessarily be governed by the circumstances of the case." S. Rep. No. 989, 95th Cong., 2d Sess. 120-121 (1978).

The flexibility of the Bankruptcy Code's disclosure requirements was also noted by the Eighth Circuit Court

of Appeals in *In re Monnier Brothers,* 755 F.2d 1336, 1342 (8th Cir. 1985).

The adequate information requirements are further summarized in 5 *Collier on Bankruptcy,* para. 1125.03, pp. 1125-20 through 1125-23 (15th ed. 1988) as follows:

> "The definition of 'adequate information' contained in section 1125 (a)(1) must be considered in conjunction with the phrase, 'investor typical of holders of claims or interest of the relevant class' which is defined in section 1125 (a)(2). The definition contained in section 1125 (a)(2) is most important since it is an acknowledgement of the fact that the quality of information available to members of a given class will vary and the sophistication of members of such class may also vary. Section 1125 (a)(2) also reflects the awareness of the draftsmen that *there may be differences with respect to the sophistication of members of different classes and the relative access of such classes to the relevant information.*
>
> "For example, . . . [a bank] presumably will be more sophisticated in financial matters than the trade creditor and, depending on the circumstances of the case, may have access to detailed current and historical financial information concerning the debtor's business which is not, and has not been, available to the trade. . . .
>
> "In determining whether a disclosure statement contains 'adequate information,' . . . the court must consider whether the typical member of a class is able to obtain sufficient information to make a reasonable judgment *from sources other than the information statement which must be furnished under section 1125(b)*
>
> . . . .
>
> "Since the purpose of a disclosure statement is to provide interested parties with enough information so that they are able to make intelligent decisions regarding the plan, a determination as to the adequacy of the contents of the disclosure statement will necessarily depend upon the circumstances of each case." (Emphasis added.)

The Third Circuit disregarded and contravened the provisions of section 1125 of the Bankruptcy Code and the Congressional intent behind those provisions in concluding that Petitioner failed to announce its claim against Respondent. Worse still, the Court used its faulty conclusion as a basis to dismiss Petitioner's action against Respondent, to the detriment of Petitioner and its creditors and in further contravention of the purposes behind the Bankruptcy Code.

The Third Circuit gave no consideration to the facts and circumstances of Petitioner's bankruptcy case, upon which a determination of inadequate disclosure depends pursuant to 11 U.S.C. section 1125. The Court did not give any consideration to the detailed information included in Petitioner's disclosure statement; it took into account only what was excluded. The Court did not give any consideration to the fact that the Bankruptcy Court had determined that Petitioner's disclosure statement *did* contain adequate information. The Court did not give consideration to the fact that Respondent was the only creditor in its class in Petitioner's bankruptcy case, so that the adequacy of the information provided to Respondent in the disclosure statement was to be determined independent of the adequacy of the information for purposes of all other creditors. The Court did not give any consideration to the fact that Respondent was a sophisticated creditor presumably with greater sources of knowledge than trade creditors. The Court did not give any consideration to the fact that Petitioner's disclosure statement properly set forth "the incidents which led to the filing of the Chapter 11," *see In re A.C. Williams Co.*, 25 B.R. 173, 176 (Bankruptcy N.D. Ohio 1982), from which the sophisticated Respondent should have been fully aware that Petitioner claimed that Respondent's wrongful conduct caused Petitioner to file its petition.

Essentially, the decision of the Third Circuit advocates form over substance, concerning itself with whether

Petitioner's disclosure statement explicitly mentioned a claim against Respondent rather than with whether, from the disclosure statement and other sources of knowledge, Respondent knew Petitioner had a claim against it. The danger here is that a debtor, having prepared a disclosure statement that contains adequate information for purposes of its proceeding under Chapter 11 of the Bankruptcy Code, will be deprived of certain rights, to its detriment and the detriment of its creditors, at the whim of a Court that decides, without regard to the facts and circumstances of the case, that the disclosure statement should have said more.

Indeed, it is manifest from the very nature of the issue of "adequate information" under section 1125(a) of the Bankruptcy Code that the issue is not a proper one for determination on a motion pursuant to Rule 12(b)(6) or 12(c). The Court should not have made such a determination without the benefit of a factual record on that issue.

The Third Circuit's legal conclusion that Petitioner's disclosures in its bankruptcy case were informationally deficient is thus repugnant to the Bankruptcy Code and the intent of Congress.

The matter requires intervention by this Court in order to uphold the integrity of the Congressional intent behind the provision for disclosure statements. The Bankruptcy Code contemplates that the adequacy of the information included in a disclosure statement depends on the facts and circumstances of the case. The decision of the Third Circuit, if left undisturbed, eschews that principle in favor of one in which the adequacy of the disclosure statement depends on the exclusion or inclusion of certain items, without regard to the creditors' actual knowledge or other sources of knowledge in a case. The intervention of this Court is also necessary because the Third Circuit's misuse of section 1125 of the Bankruptcy Code is prejudicial to debtors and creditors in cases under Chapter 11, whom the Code is intended to protect.

**III. The Third Circuit Reached a Decision That Is Contrary to the Spirit and Purposes of the United States Bankruptcy Code by Making Impermissible Assumptions of Fact, Contrary to Established Federal Judicial Procedure.**

Petitioner submits that this case is appropriate for review by this Court because it presents significant issues of federal bankruptcy law that this Court has not previously decided and that the Third Circuit has decided in a manner contrary to the underlying purposes of the Bankruptcy Code.

Petitioner further submits that intervention by this Court is appropriate because the Third Circuit departed from the usual and accepted judicial procedure on motions under Rule 12(b)(6) or 12(c), or even Rule 56, of the Federal Rules of Civil Procedure. Those Rules dictate that a court addressing a motion to dismiss for failure to state a claim, a motion for judgment on the pleadings, or a motion for summary judgment, must read the pleadings and factual matter in the light most favorable to the party opposing the motion. If the court finds that there exist issues of fact that need to be resolved, the court shall not decide those issues of fact. Rather, the court must deny the motion. *Lang v. New York Life Insurance Co.*, 721 F.2d 118, 119 (3d Cir. 1983) (summary judgment); *Angleton v. Pierce*, 574 F. Supp. 719, 723 & n. 1 (D. N.J. 1983), aff'd 734 F.2d 3 (3d Cir. 1984), *cert.* denied 469 U.S. 880 (1984) (judgment on pleadings); *Alken v. Lerner*, 485 F. Supp. 871, 873 (D. N.J. 1980) (judgment on pleadings). In the instant case, the Third Circuit improperly decided issues of fact in reaching its legal conclusion. Moreover, it did so without the benefit of any factual investigation or evidentiary hearing. The Third Circuit *assumed* certain material facts, used those assumptions to resolve issues of fact *adversely* to the party opposing the motion, and then used its resolution of the issues of fact to determine that Respondent was entitled to judgment as a matter of law.

Indeed, the Third Circuit went out of its way to decide the legal issues in a way that contravenes the spirit

and purpose of the Bankruptcy Code. This Court should intervene in order to exercise its "supervisory powers over federal courts . . . to protect the integrity of the federal system." *Cf. Frazier v. Heebe,* 107 S. Ct. 2607, 2612 n. 7 (1987).

The Third Circuit prefaced its discussion of the legal issues by stating: "The historical facts are undisputed." (App. 6) It is clear from the Court's opinion, however, that there did exist disputes of material fact, but that the Court was content to assume the facts it needed in order to apply the legal precepts it chose to apply. The Court cited no legal authority to support its assumption-making exercise.

First, the Third Circuit determined that Petitioner's disclosure statement and plan of reorganization were informationally deficient. As discussed in Point II, *supra,* however, the Bankruptcy Code clearly contemplates that what constitutes "adequate information" in a disclosure statement depends upon the facts and circumstances of each case. Thus, whether Petitioner's disclosures were informationally deficient, particularly *vis-a-vis* Respondent —the sophisticated bank that constituted its own class of creditors—was *not* an undisputed historical fact. Petitioner respectfully submits that the court below could not resolve that fact question without a full examination of the facts and circumstances, and in any event should not have made a finding of informational deficiency on a motion under Rule 12, or 56, of the Federal Rules.

Similarly, the Court should not have concluded that the record in Petitioner's bankruptcy case was "deafeningly silent" with regard to the claim against Respondent. Whether Petitioner's disclosures were adequate is a disputed question of fact that requires an examination of all the underlying circumstances—the sophistication of the Respondent, the Respondent's own knowledge of its wrongful acts, the Petitioner's refusal to give Respondent a general release, the contents of Petitioner's disclosure statement that clearly depicted Respondent's malfeasance

as the cause of Petitioner's bankruptcy, and the express reservation to Petitioner and its Creditors Committee of claims and causes of action not expressly released, to name a few. (See dissenting opinion of Judge Stapleton at App. 22-23 & n.7.) The Third Circuit's conclusion that Petitioner's disclosures were inadequate clearly violated both the Bankruptcy Code and the Federal Rules of Civil Procedure. Absent a proper determination of that disputed question of material fact the court below could not validly comment on the silence or lack of silence of the record in Petitioner's bankruptcy case.

The Third Circuit then proceeded to "assume" that if Petitioner had revealed its potential action against Respondent, that would have had an impact on Respondent's "decision to enter into the stipulation establishing the extent and validity of its lien against [Petitioner] and to vote for confirmation." (App. 10) The court below took its improper resolution of the fact question of adequacy of disclosure and used that improper resolution to "assume" that adequate disclosure would have had some impact on Respondent's participation in Petitioner's bankruptcy case. Petitioner submits that that step in and of itself represents a radical departure from the accepted course of judicial proceedings. The Court's unusual behavior is exacerbated, however, by the fact that the Court's assumption makes no sense. Why would Respondent refuse to stipulate to the extent and validity of its lien against Petitioner? Such a refusal would not increase the extent and validity of that lien. It would only interfere with Respondent being paid. Thus, Respondent would not have benefitted from refusing to enter into the stipulation. Furthermore, Respondent *did not* vote for confirmation of Petitioner's plan of reorganization. Therefore, the Third Circuit's assumption that fuller disclosure by Petitioner would have affected Respondent's decision to vote for confirmation was not only procedurally improper, but also substantively erroneous.

The Third Circuit did not stop there, however. It proceeded to affirm dismissal of Petitioner's Complaint on

grounds of equitable and judicial estoppel. The doctrine of equitable estoppel is entirely fact-sensitive. Its application here requires a finding of the *fact* of some action or inaction by Petitioner, followed by a finding of the *fact* of some action or inaction taken in reliance thereon by Respondent, and a finding of the *fact* that that reliance was detrimental to Respondent. The Third Circuit improperly determined that, as a matter of fact, Petitioner made inadequate disclosures. The Third Circuit then *assumed* that Respondent did, or refrained from doing, something in reliance on Petitioner's alleged inadequate disclosure. The Third Circuit further assumed that Respondent was somehow prejudiced thereby, which even the scanty record that was before the court below clearly shows not to have been the case. (See dissenting opinion of Judge Stapleton at App. 24 & n.8.)

The Third Circuit, feigning concern for Petitioner's creditors, went on to suggest that the application of equitable estoppel was appropriate because "the creditors had reasonably acted in reliance upon the assumed finality" of Petitioner's confirmed Plan of Reorganization. (App. 10) Most respectfully, Petitioner submits that the only actions the creditors took in reliance on the confirmed Plan was to resign themselves to receiving only 25 to 30 percent of their claims. The Third Circuit has now managed to dash any hopes the creditors briefly harbored that commencement of this lawsuit against Respondent might increase their dividend. (See dissenting opinion of Judge Stapleton at App. 21.) In effect, the Third Circuit, by completely disregarding the purposes of the Bankruptcy Code, not only gave a windfall to a tortfeasor—Respondent—, but in so doing ran roughshod over the Federal Rules of Civil Procedure.

The next improper assumption by the Third Circuit was that, had Petitioner's possible claim against Respondent been made known, "neither the bankruptcy court, nor particularly [Respondent], would have agreed to allow [Petitioner] to utilize [cash] collateral." (App. 12) The

cash collateral order was entered by the bankruptcy court on July 25, 1985. Implicit in the Third Circuit's decision, therefore, was the concept that a possible claim that would normally carry a six year statute of limitations has to be mentioned by a debtor within two weeks after commencement of a bankruptcy case lest the debtor thereafter be precluded from asserting that claim. Once again contrary to the purposes of the Bankruptcy Code to rehabilitate debtors, the Third Circuit interprets the Code to impose incredible mandatory disclosure requirements on a debtor, with unmitigatedly harsh penalties.

Moreover, there is nothing in the record that would permit the court below to conclude what the bankruptcy court would or would not have allowed Petitioner to do regarding its need for cash collateral. Does the Third Circuit mean to suggest that if Petitioner had disclosed to the bankruptcy court that it might have a claim against Respondent,* the bankruptcy court would have responded by refusing to allow Petitioner to use cash collateral, leaving Petitioner no choice but to liquidate immediately? Considering the purposes of the Bankruptcy Code and the practicality of bankruptcy proceedings, the bankruptcy court clearly would have done nothing different with regard to Petitioner's application to use cash collateral.

Nor is there anything in the record to suggest that knowledge of Petitioner's potential claim against it (*assuming* Respondent lacked such knowledge) would have changed Respondent's attitude toward Petitioner's use of cash collateral. Respondent *objected* to Petitioner's application to use cash collateral anyway, so its attitude could only have gotten better. Respondent only allowed Petitioner to use cash collateral because the bankruptcy court ordered it to do so, in return for which Respondent received super-priority status and additional collateral.

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* Again, the Third Circuit could only *assume* the bankruptcy court did not already know this.

Thus, the Third Circuit employed the doctrine of equitable estoppel, despite the existence of genuine issues of material fact, by assuming the fact of detrimental reliance.

Similarly, the doctrine of judicial estoppel requires a determination of facts that: in its bankruptcy case, Petitioner assumed a position that it had no claim against Respondent; and subsequent to its bankruptcy case, Petitioner assumed the contrary position. These are issues of material fact that require an examination of the facts and circumstances of the case, including the knowledge of the affected parties. By assuming the essential facts, the Third Circuit took an impermissible shortcut to the legal conclusion that judicial estoppel bars this lawsuit. (See also the dissenting opinion of Judge Stapleton at App. 22-24 as to the inapplicability of judicial estoppel.)

As part of its authority to review the procedures of lower federal courts, it is respectfully suggested that this Court should not permit the courts so to use procedural technisms to thwart the determination of the merits of significant claims to the detriment of debtors and unsecured creditors, when factual issues exist.

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## CONCLUSION

This Court should grant a *Writ of Certiorari* in order to review the important questions of Federal Law that are presented under the United States Bankruptcy Code and in order to nullify the Third Circuit's egregious disregard of the usual and accepted course of proceedings pursuant to the Federal Rules of Civil Procedure.

Respectfully submitted,

Allan H. Klinger
Counsel of Record
KLINGER, NICOLETTE,
MAVROUDIS AND HONIG

Dated: Oradell, New Jersey
September 29, 1988

# APPENDIX TO PETITION FOR CERTIORARI

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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No. 87-5525

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ONEIDA MOTOR FREIGHT, INC.,
a Corporation of the State
of New York,

*Appellant*

vs.

UNITED JERSEY BANK, a Corporation
organized under the Banking Laws
of the United States of America

-and-

UNITED JERSEY BANK, a New Jersey
Corporation,
Deft.-Third Pty. Pltf.

vs.

DONALD T. SINGLETON,
Third Pty. Deft.

Action for Referral to Bankruptcy Court

In re: ONEIDA MOTOR FREIGHT, INC.
Debtor, B.C. #85-03606(DV)

Appeal from the United States District
Court for the District
of New Jersey—Newark
(D.C. Civil No. 87-1440)

Argued
February 1, 1988
Before: SLOVITER, STAPLETON, and MANSMANN,
*Circuit Judges*

(Filed May 31, 1988)

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OPINION OF THE COURT

MANSMANN, *Circuit Judge.*

Oneida Motor Freight, a Chapter XI debtor, appeals the dismissal of its contract and tort action against United Jersey Bank, a secured creditor. We must determine whether Oneida, seeking damages for the bank's alleged breach of certain loan agreements, is estopped from litigating this action by the preclusive effect of prior bankruptcy proceedings.

We conclude that Oneida violated both its statutory and fiduciary duty to disclose this current claim against the bank during the pendency of the bankruptcy case. By virtue of this failure to disclose, equitable and judicial estoppel operate against further litigation by Oneida. Accordingly, we shall affirm the order of the district court.

I.

Oneida Motor Freight, engaged in the interstate and intrastate trucking industry, and United Jersey Bank have maintained a banking relationship since 1983. In the course of their business dealings, the parties entered into two lending agreements. Under the terms of a "Revolving Credit Agreement", the bank would extend up to five million dollars in credit through loans and letters of credit. The parties also negotiated an "Accounts Receivable Security Agreement", whereby the bank would lend Oneida a percentage of Oneida's accounts receivable while maintaining a security interest in Oneida's accounts, equipment and inventory. The lending limits of these agreements have never been reached or exceeded.

In February 1985, Oneida settled a dispute which arose in connection with its acquisition of another trucking company, Dorn Transportation Company. In order to satisfy its obligations under the terms of the settlement, Oneida called upon the bank to pay certain outstanding letters of credit. Rather than charging against the letters of credit, however, the bank withdrew the necessary funds from Oneida's operating account. As a result, Oneida's account became habitually overdrawn. Nonetheless, at least for a period time, the bank honored Oneida's overdrafts.

In July 1985, the bank requested that the owner of Oneida, Donald Singleton, personally guarantee Oneida's debt. According to Oneida, when Mr. Singleton refused, the bank ceased honoring Oneida's checks. The dishonor of these checks allegedly compelled Oneida, on July 10, 1985, to file a petition under Chapter XI of the Bank-

ruptcy Code. Oneida then ceased its operations and proceeded with liquidation.

On July 11, 1985, the bank filed a motion for relief from the automatic stay entered in the bankruptcy proceeding. The application for relief further sought an order establishing the validity and extent of the bank's lien. On that same date, Oneida requested permission of the bankruptcy court for Oneida to use cash collateral of the bank, which was granted.

A series of subsequent orders was entered by the bankruptcy court in regard to matters pertaining to Oneida's and the creditors' rights, including, on September 30, 1985, a stipulation and order confirming a settlement among the bank, Oneida and the official unsecured creditors' committee. This order provided for an unconditional payment by Oneida to the bank in the amount of $6,650,000. Thereafter, on January 14, 1986, an order and a judgment were entered by the bankruptcy court, further detailing the extent and validity of the bank's lien. In this order, the amount due the bank by Oneida was established at $7,631,322.73 an amount already paid in full.

On August 14, 1986 the bankruptcy court entered an order confirming Oneida's Joint Plan of Reorganization. Nowhere in the plan or in the confirmation order is reference made to Oneida's current claim against the bank.[1]

Approximately seven months later, on March 11, 1987, Oneida commenced this action against the bank in the Su-

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1. After the present action was filed in state court, the plan was modified to order that one-third of the net recovery that Oneida might obtain against the bank in this lawsuit be paid to the creditors.

perior Court of New Jersey. In its complaint, Oneida alleged breaches of the credit agreements, of the parties' course of dealing and of the bank's duty of good faith. Oneida also set forth a cause of action in tort for fraudulent misrepresentation on the part of the bank and its agents. Oneida alleged that the bank's prior assurances, coupled with its dishonor of certain checks "without notice" denied Oneida an adequate opportunity to seek alternate financing to satisfy the payees of the dishonored checks. Oneida additionally asserted that the actions of the bank seriously damaged its business reputation with its customers and creditors. Oneida cited these improper activities by the bank as the catalyst for its Chapter XI filing.

The bank filed an answer and a third party complaint against Donald Singleton, Oneida's sole shareholder.[2] The bank then removed the action to the U.S. District Court for the District of New Jersey.

On May 14, 1987 the bank moved to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6), failure to state a claim upon which relief can be granted, and/or Rule 12(c), motion for judgment on the pleadings. The district court, after argument, dismissed the complaint. The court held that since Oneida's claims against the bank arose from the same series of transactions which were the subject of the extensive prior bankruptcy proceedings, its failure to bring this particular claim to the bankruptcy court's attention violated fundamental principles of preclusion and barred Oneida from proceeding with the action.

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2. By order of June 24, 1987, the district court granted Singleton's motion to dismiss the third party complaint.

Oneida filed a notice of appeal from this final decision of the district court. We have jurisdiction under the authority of 28 U.S.C. § 1291.

The historical facts are undisputed. It is the preclusive effect of the bankruptcy proceeding upon this current action, if any, which is contested; resolution involves interpretation of legal precepts over which we invoke our power of plenary review.[3]

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3. The bank captioned its motion as, alternatively, a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) and/or Rule 12(c). The district court granted the bank's motion without comment as to which procedural rule it applied.

Oneida argues that the motion should have been handled as a motion requesting summary judgment and asserts that the presence of unresolved factual matters mandate that the order entered in the bank's favor be reversed.

The district court characterized this argument as "irrelevant" since its decision was based on the legal question of the preclusive effect of the bankruptcy proceeding. The court then determined that no discovery was necessary for Oneida to defend against the bank's res judicata argument.

In deciding the merits of Oneida's argument, we are unable to discern which precise facts the district court relied upon, *i.e.*, what comprised "the current record." Under either motion, however, the district court had to examine the record of the prior bankruptcy proceeding. Indeed, the district court was entitled to take judicial notice of these matters in rendering its decision, regardless of the motion employed. Green v. Warden, U.S. Penitentiary, 699 F.2d 364 (7th Cir. 1983); 2A J. Moore, J. Desha Lucas and G. Grotheer, Moore's Federal Practice ¶ 12.15 (2d ed. 1987).

Review of the legal component for either of the motions is identical—since the material facts here are the undisputed historical facts—we determine, as did the district court, whether the moving party, the bank, is entitled to judgment as a matter of law.

## II.

A long-standing tenet of bankruptcy law requires one seeking benefits under its terms to satisfy a companion duty to schedule, for the benefit of creditors, all his interests and property rights. *In Re Hannan,* 127 F.2d 894 (7th Cir. 1942).

Section 521 of the current Bankruptcy Code outlines a non-exhaustive list of the debtor's duties in a bankruptcy case. Foremost for our purposes, the debtor is required to "file a . . . schedule of assets and liabilities . . . and a statement of the debtor's financial affairs. . . ." 11 U.S.C. § 521(1)(1978).

An additional obligation is imposed by 11 U.S.C. § 1125(b) mandating the filing of a disclosure statement containing "adequate information." Section 1125(a) defines adequate information as follows:

> § 1125. Postpetition disclosure and solicitation
>
> (a) In this section—
>
> (1) "adequtae information" means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor . . . that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan. . . .

Concomitant with these prescribed duties is the debtor's "absolute and unlimited right to be heard in reorganization proceedings." *Southmark Properties v. Charles House Corp.,* 742 F.2d 862, 871 (5th Cir. 1984).

We regard the right-conferring language of *Southmark* as confirmation of the debtor's express obligation of candid disclosure. The preparing and filing of a disclosure statement is a critical step in the reorganization of a Chapter XI debtor. One commentator, citing the relevant legislative history, labeled this duty as the pivotal concept in reorganization procedure under the Code. 5 Collier on Bankruptcy ¶ 1125.03 (15th ed. 1988).

The importance of full disclosure is underlaid by the reliance placed upon the disclosure statement by the creditors and the court. Given this reliance, we cannot overemphasize the debtor's obligation to provide sufficient data to satisfy the Code standard of "adequate information."

From the legislative history of § 1125 we discern that adequate information will be determined by the facts and circumstances of each case. H.R. Rep. No. 595, 97th Cong., 1st Sess. 266 (1977). It has been specifically held that a debtor must disclose any litigation likely to arise in a non-bankruptcy contest. *Monroe County Oil Company v. Amoco Oil Co.*, 75 B.R. 158 (Bankr. S.D. Ind. 1987). The result of a failure to disclose such claims triggers application of the doctrine of equitable estoppel, operating against a subsequent attempt to prosecute the actions. *In Re Galerie Des Monnaies of Geneva Ltd.*, 55 B.R. 253 (Bankr. S.D. N.Y. 1985), *aff'd*, 62 B.R. 224 (Bankr. S.D. N.Y. 1986).

A strong interest to achieve finality pervades Chapter XI arrangements. *Bohack Corp. v. Iowa Beef Processors, Inc.*, 715 F.2d 703 (2d Cir. 1983). This goal of finality was supported by the Supreme Court in *Stoll v. Gottlieb*,

305 U.S. 165 (1938), holding that confirmation of a plan acts to bar attempts by the parties to relitigate any of the matters that could have been raised during the bankruptcy proceedings. 5 Collier on Bankruptcy ¶ 1141.01(1) (15th ed. 1988). *See also, In Re Penn Central Transportation Co.*, 771 F.2d 762 (3d Cir. 1985), *cert. denied,* 474 U.S. 1033 (1985).

Disclosure is important, in this case, not only to the bank as an adversary and as a creditor, but to the other creditors and to the bankruptcy court. Here, "the silence" in the Oneida bankruptcy record concerning this present claim, as they say in the vernacular, "is deafening." In Schedule A-2 of its Statement of Financial Affairs required by § 521, Oneida acknowledged its debt to the bank in the amount of approximately 7.7 million dollars, without any mention of a setoff. The debt to the bank in part represented principal and interest due on the lending agreements, the alleged breach of which Oneida now seeks to place at issue. In the portion of the statement requiring enumeration of "contingent and unliquidated claims of every nature, *including counterclaims* . . .", Oneida listed only an unrelated accounts receivable claim of $6,827,030. (Emphasis added.) We conclude that the reorganization plan presented by Oneida to the creditors for confirmation, lacking disclosure of the potential for recovery against the bank, was informationally deficient, and not cured by the later modification.[4] The original plan failed to alert the creditors to the possible financial benefits enuring to them upon the successful prosecution of the claim.

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4. See supra note 1.

We can assume that revealing the potential action may also have impacted upon the bank's decision to enter into the stipulation establishing the extent and validity of its lien against Oneida and to vote for confirmation. The practical effect of a successful prosecution of Oneida's claim would be to require the bank to make restitution of the amount realized on its bankruptcy claim, since Oneida's present action calls into question the bank's right to collect its secured debt. This would also constitute a successful collateral attack on the bankruptcy court's order confirming the reorganization plan. In such circumstances, employment of equitable estoppel is required to preserve the integrity of the earlier proceedings, particularly where, as here, the creditors have reasonably acted in reliance upon the assumed finality and integrity of those adjudications. *County Fuel Company v. Equitable Bank Corporation,* 832 F.2d 290 (4th Cir. 1987).

In order to preserve the requisite reliability of disclosure statements and to provide assurances to creditors regarding the finality of plans which they have voted to approve, we hold that under the facts here present Oneida's failure to announce this claim against a creditor precludes it from litigating the cause of action at this time.

III.

Oneida asserts that it did not make known the presence of this cause of action during the course of the bankruptcy proceeding primarily because the bankruptcy matter was never in a procedural posture for a proper assertion of this claim.

Oneida argues that the bank's decision to commence a "contested matter" when requesting relief from the automatic stay rather than instituting an "adversary proceeding" foreclosed Oneida's obligation to raise this current claim. Oneida notes that Bankr. Rule 9014, governing contested matters, delineates other bankruptcy rules which can apply to contested matters. Rule 9014 does not, however, cross-reference Rule 7008, allowing for a debtor to raise affirmative defenses to a creditor's claim, or Rule 7013, allowing a debtor to assert counterclaims against a creditor.

Recognizing that Rule 9014 allows the bankruptcy court, at any stage in a particular matter, to direct that the unenumerated rules of Chapter VII shall apply, Oneida states that it could not raise its claim because the bankruptcy court did not utilize this permissive authority. We are somewhat surprised by this argument because the bankruptcy court was totally unaware that Oneida thought it had such a claim and the bankruptcy court was, therefore, never in a position to direct application of rules which might otherwise have been applicable.

Oneida further argues that it had no obligation to raise the claim when the bank sought relief from the automatic stay. Oneida cites several cases for the proposition that a motion for relief from stay, as brought by the bank under 11 U.S.C. §§ 362(d), is not the proper setting for adjudication of a counterclaim. *See, e.g., In Re Lexington Racquetball Club, Inc.*, 58 B.R. 103 (Bankr. E.D.Pa. 1986); *In Re Transleisure Corp.*, 41 B.R. 201 (Bankr. E.D.N.Y. 1984). Despite these cases, it is clear that while stay proceedings may not be proper for adjudication of a counter-

claim, a party may, nevertheless, raise its counterclaim at that time. One court noted:

> The Court fully agrees that a preliminary hearing under § 362 is not the proper time or place for a full *adjudication* of the trustee's clams against the creditor. . . . However, there is a tremendous difference between *adjudication* of the merits and mere *consideration* of counterclaims and defenses.

*In Re Tallywell Services, Inc.*, 45 B.R. 149, 151 (Bankr. E. D.Mich. 1984). S. Rep. No. 95-989, 95th Cong., 2d Sess. 66 (1978).

The next procedural event providing an opportunity to bring this present claim to the forefront in the bankruptcy proceeding occurred when a hearing was held regarding Oneida's request, opposed by the bank, for use of cash collateral. After testimony, the parties consented to a cash collateral arrangement and partial vacation of the automatic stay which were memorialized in the bankruptcy court's order of July 25, 1985. It is not unreasonable to conclude that neither the bankruptcy court, nor particularly the bank, would have agreed to allow Oneida to utilize the collateral in the hands of the bank if a question as to the bank's threshold right to the funds was put at issue.

Oneida also asserts that it had no obligation to raise the claim when the bankruptcy court entered orders confirming validity of the bank's loan. Four separate orders were entered regarding the validity, priority and extent of the bank's claim against Oneida. The end result of these orders was the establishment and confirmation of the amount of the bank's claim for 7.7 million dollars. No affirmative defenses, counterclaims or objections to the claim

were pleaded or raised in connection with entry of these orders. Oneida contends that these orders involve different causes of actions than those presented by the district court complaint, and thus did not provide an opportunity to raise its defense to the claim. As we discuss later, we reject this argument of Oneida's, finding instead that the two claims stem from the same transaction, *i.e.*, alleged breaches of the loan agreement present an issue of fact common to the matters before the bankruptcy court in determining the extent and validity of the bank's lien based on the loan agreement.

Although Oneida may be technically correct in its argument that it was never *procedurally* compelled to raise its claim, we are satisfied that its failure to mention this potential claim either within the confines of its disclosure statement or at any stage of the bankruptcy court's resolution precludes this later independent action. Even absent a specific mandate to file a counterclaim, complete disclosure is imperative to assist interested parties in making decisions relevant to the bankrupt estate.

## IV.

We are also mindful of the equitable concept of judicial estoppel. This doctrine, distinct from that of equitable estoppel, applies to preclude a party from assuming a position in a legal proceeding inconsistent with one previously asserted. Judicial estoppel looks to the connection between the litigant and the judicial system while equitable estoppel focuses on the relationship between the parties to the prior litigation. *Scarano v. Central Railroad Co.*, 203 F.2d 510 (3d Cir. 1953); *USLIFE Corp. v. U.S. Life Insurance Co.*, 560 F. Supp. 1302 (N.D. Tex. 1983).

We conclude that Oneida's failure to list its claim against the bank worked in opposition to preservation of the integrity of the system which the doctrine of judicial estoppel seeks to protect. Although we stop short of finding that, as the bank urges, Oneida's prior silence is equivalent to an acknowledgement that it did not have a claim against the bank, we agree that its current suit speaks to a position clearly contrary to its Chapter XI treatment of the bank's claim as undisputed.

Oneida argues that judicial estoppel is not applicable because the claims raised in this lawsuit are entirely different, factually and legally, from those matters addressed in the bankruptcy proceeding.[5] In light of Oneida's thres-

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5. This is the identical argument raised in both Oneida's contest of the district court's application of the preclusion principle of res judicata to this matter and Oneida's rationale for not raising its claim in the bankruptcy forum.

In reaching its decision to apply res judicata here, the district court indicated what we described in United States v. Athlone Industries, Inc., 716 F.2d 977 (3d Cir. 1984), as "a predisposition towards taking a broad view of what constitutes identity of causes of action—'an essential similarity of the underlying events giving rise to the various legal claims.' " *Id.* at 984, citing Davis v. United States Steel Supply, 688 F.2d 166, 1971 (3d Cir. 1982) (in banc), *cert. denied,* 460 U.S. 1014 (1983). Without further elaboration, the district court then found that the current claims for breach of contract and misrepresentation were part of the same cause of action before the bankruptcy court, thereby barring further litigation of the present suit.

Because the matter here originated as a bankruptcy petition and was adjudicated in a format peculiar to bankruptcy matters, comparison of the two actions is not susceptible to the four-step analysis outlined in *Athlone.* Rather, we scrutinize the totality of the circumstances in each action and then determine whether the primary test of *Athlone, i.e.,* essential similarity in the underlying events, has been satisfied. Since it is Oneida's

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hold assertion in its district court complaint that the bank's breach of the lending agreements was the catalyst to its Chapter XI filing, we are unpersuaded by this argument. The relative rights and obligations of these parties are embodied in the lending agreements and the parties' course of dealing. To be successful in this action, Oneida must demonstrate a deviation from the contracted-for and established business relationship—a deviation which would certainly call into question any rights which the bank could assert as a creditor of Oneida for obligations accruing under the lending agreements. *Cf. Paradise Hotel Corporation v. Bank of Nova Scotia,* No. 87-3318, slip op. (3d Cir. March 15, 1988) (debtor, after filing a voluntary bankruptcy petition, requested the bankruptcy court to stay a previously-filed involuntary petition; debtor's stated motivation was to preserve potential claims arising from filing of the involuntary petition to pursue these claims later).

V.

The district court, although focusing primarily upon basic principles of res judicata, properly stressed the debtor's special duty of candid disclosure when it granted the bank's motion to dismiss.

While the result of terminating this lawsuit may produce a harsh result to other creditors of Oneida whose

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threshold allegation that the bank's activity in connection with the lending agreements was the catalyst to Oneida's filing a Chapter XI petition, we are unpersuaded by Oneida's current position that the two actions represent unrelated events. In any event, because the concept of equitable estoppel in relation to the debtor's duty of disclosure is dispositive in this matter, we need not further address this issue.

claims have not been paid in full, we are mindful of our review authority here—we have been asked to rule only on the propriety of the district court's conclusion with respect to the bank. Although we focus our decision on estoppel by reason of failure to disclose, we cannot say that the district court erred in its result. We shall affirm the order of the district court.

STAPLETON, *Circuit Judge,* Dissenting:

Concern for Oneida's numerous unsecured creditors compels me to dissent from the court's disposition. Those creditors, as well as Oneida, stand to lose by virtue of that disposition. If Oneida had been able to foresee this court's novel application of equitable and judicial estoppel, it would have been able to protect itself against the loss the court today imposes upon it. Oneida's unsecured creditors, however, had no way of protecting themselves and should not be required to contribute towards a windfall for an alleged wrongdoer.

I.

The court professes to steer clear of the claim preclusion analysis that underlies the district court's decision. It does so, however, only in the wake of an analysis sounding as much in claim preclusion as in the estoppel theories it embraces, and in a fashion which reflects, at most, only minor quibbles with the district court's view. I therefore begin with a discussion of the claim preclusion issue.

In effectuating the indisputable public interest in finality in bankruptcy proceedings, courts apply ordinary rules of claim and issue preclusion in the bankruptcy context. *See e.g. Miller v. Meinhard-Commercial Corp.*, 462

F.2d 358, 360 (5th Cir. 1972); *Virgin Islands Bureau of Internal Revenue v. St. Croix Hotel Corp.*, 60 B.R. 412, 414 (D. V.I. 1986). Restatement (Second) of Judgments § 24(1) sets forth the general rule which respect to claim preclusion, stating that:

> When a valid and final judgment rendered in an action extinguishes the plaintiff's claim pursuant to the rules of merger or bar . . . the claim extinguished includes all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose.

The court is simply mistaken, as was the district court, to the extent it suggests that this principle directs the outcome reached in this case. Section 24(1) prohibits claim-splitting, which by definition occurs when a party who has once asserted a claim attempts to reintroduce the claim in another guise thereafter. Here, Oneida asserted no claim against the bank in the bankruptcy proceedings. Having made no previous attempt to pursue a claim against the bank, Oneida cannot now be said to be prosecuting, and forcing the bank to defend, a suit for the second time.

One might argue to greater effect that Oneida's claims are precluded because Oneida did not file a counterclaim in response either to the bank's proof of claim or to its motion to lift the automatic stay and determine the extent and validity of its lien. Section 22(2) of the Restatement (Second) of Judgments states:

> A defendant who may interpose a claim as a counterclaim in an action but fails to do so is precluded, after the rendition of judgment in that action, from maintaining an action on the claim if:

> (a) the counterclaim is required to be interposed by a compulsory counterclaim statute or rule of court, or
>
> (b) the relationship between the counterclaim and the plaintiff's claim is such that successful prosecution of the second action would nullify the initial judgment or would impair rights established in the initial action.

For me, analysis of this case under this applicable legal principle dispels any doubt about whether it is barred by claim preclusion. As the majority acknowledges, no compulsory counterclaim statute or rule required Oneida to assert its claim in the bankruptcy proceedings. Because the bank's motion to establish the validity and extent of its lien and to lift the automatic stay gave rise to contested, rather than adversary proceedings, Bankruptcy Rule 9014 governed and Fed. R. Civ. P. 13(a)[1] was inapplicable absent explicit court direction to the contrary. The court issued no such direction. Similarly, while the Code calls for the disclosure of claims, as we discuss hereafter, no Code provision requires that the debtor actually litigate in the bankruptcy proceedings any claim the debtor happens to have against one of its creditors.[2] Indeed, as noted in our

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1. Rule 13(a) states that: "A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurence that is the subject matter of the opposing party's claim . . ."

2. The absence of such a rule is consistent with § 553, the Code's setoff provision. Section 553 permits a creditor to exercise a right of setoff, but does not require the creditor to do so. The absence of a rule also is consistent with our recent decision in *Paradise Hotel Corp. v. Bank of Nova Scotia,* No.

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subsequent discussion, Oneida's reorganization plan provides by its very terms, *See* Article XII, App. at 146,[3] that all claims and causes of action of Oneida's not expressly released or terminated in accordance with the plan may be prosecuted by Oneida or the Creditor's Committee after entry of the confirmation order.

Nor can it be said that Oneida's decision to prosecute its claims now, after the close of the bankruptcy proceedings, threatens to undermine a judgment of the bankruptcy court and thus that Oneida's claims should be barred on that basis. *See* Restatement (Second) of Judgments § 22(2)(b).[4] While the court suggests that such a danger is presented by the facts of this case, I fail to see the logic of its argument. The bankruptcy court entered orders re-

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87-3318, slip op. (3d Cir. March 15, 1988), where we held that a debtor who believes that an involuntary bankruptcy proceeding was filed against it in bad faith may pursue its remedies after bankruptcy, rather than relying exclusively on the relief provided by the Code in § 303(i)(2).

3. Article XII is quoted, *infra*, at 8.

4. In two cases cited by the court, *Southmark Properties v. Charles House Corp.*, 742 F.2d 862, 871 (5th Cir. 1984) and *County Fuel Co. v. Equitable Bank Corp.*, 832 F.2d 290 (4th Cir. 1987), courts of appeal held that claims were barred by claim preclusion in contexts where granting relief would have been inconsistent with findings of fact or conclusions of law supporting the judgment in a prior case or would have effectively rescinded relief granted in a prior case. Both holdings are supported by the principle set forth in § 22(2)(b). In *Southmark*, the debtor sought to collaterally attack an order authorizing and confirming a sale of property to the debtor's mortgagee. In *County Fuel Co.*, the debtor attempted to raise claims that, had they been successfully raised when the creditor moved for removal of the automatic stay, would have cause the court to reject the motion.

flecting the undisputed facts that the bank had loaned Oneida more than $7.6 million, that Oneida was indebted to the bank to that extent, and that the bank's lien on Oneida's property securing that amount was valid. Oneida had no basis for contesting its debt to the bank or the validity of the bank's lien and, accordingly, it did not contest the bank's applications to the bankruptcy court. Oneida now seeks to prosecute behavior by the bank, occurring after the loaning of the $7.6 million, which Oneida believes was both impermissible and directly responsible for the circumstances that led to its bankruptcy. Resolution of the question of the propriety of the bank's behavior in Oneida's favor and entry of a judgment against the bank on Oneida's claims would be entirely consistent with the determinations of the bankruptcy court that Oneida had a duty to repay the $7.6 million loaned to it and that the bank's security interest had been perfected.[5] Accordingly, I would conclude that Oneida's failure to raise its present claim as a counterclaim in the bankruptcy proceeding did not undermine the bankruptcy court's orders.

Thus, I conclude that Section 22(2) of the Restatement sets forth the applicable rule of claim preclusion

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5. There is not even a significant overlap of the evidence crucial to the motions decided in the bankruptcy court and the evidence necessary to an analysis of Oneida's current claims. The bankruptcy court's determinations required consideration of the credit agreement, the value of the liens on Oneida's property and accounts receivable, and the question whether the bank properly perfected its liens. Oneida's current claims on the other hand, would necessitate investigation of the bank's behavior immediately prior to Oneida's filing in Chapter 11. With the exception of the credit agreement itself, the evidence adduced in the bankruptcy court would likely be irrelevant to this investigation.

and that application of that rule to the facts of this case requires a conclusion that Oneida's claim is not precluded.

II.

I would also reject the equitable and judicial estoppel theories on which the court places express reliance in foreclosing Oneida's claims. The court's reasoning, in short, is that Oneida forfeited its claims when it did not list them in its disclosures pursuant to § 521, which requires every debtor to file a schedule of assets, and § 1125, which imposes a similar obligation on a debtor soliciting acceptance of a reorganization plan. In my view, the court's analysis and the remedy it endorses ignore the purposes of the Code's disclosure requirements.

The Code's disclosure requirements are intended to protect those creditors whom a debtor's failure to disclose hidden assets would prejudice. A *fortiori,* a court's response to nondisclosure should do likewise. Not only does the court fail to safeguard the interests of Oneida's unsecured creditors, but it effectively penalizes them by foreclosing the prosecution of claims against the bank that would, if successful, result in a substantial enhancement of the estate and in their receiving more than the approximately thirty cents on the dollar for which they have been forced to settle. The only real winner in the case as decided is the bank, whom the court has relieved of the responsibility of justifying its allegedly improper behavior.

The court does not explain why it finds more even-handed alternatives inadequate. I see no reason, for example, why we could not allow this suit to proceed and simply make reference to the fact that the bankruptcy

court has jurisdiction to entertain motions to amend or rescind the debtor's reorganization plan if such motions are brought by unsecured creditors who feel that Oneida's nondisclosure has prejudiced them.[6] *See* § 350(b) ("A case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause."). The availability of such a course of action would in most cases adequately deter nondisclosure. Section 1141(d)(3), which authorizes denial of discharge under certain conditions, provides additional deterrence, as does 18 U.S.C. § 152 which makes it a crime, among other things, to "knowingly and fraudulently [conceal] . . . any property belonging to the estate of a debtor." *See e.g. 3 Collier on Bankruptcy* ¶ 521.02 (15th ed. 1986) (suggesting that concealment of an asset is subject to denial of discharge or criminal sanctions pursuant to 18 U.S.C. § 152).

Moreover, this case stands in marked contrast to the circumstances under which estoppel has traditionally been invoked. Here, Oneida never represented that it would not press a claim against the bank. On the contrary, starting with its initial disclosure statement and continuing throughout the Chapter 11 proceedings, Oneida made clear that it thought it had been mistreated by the bank.[7] Hav-

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6. At oral argument, we were advised that the Creditor's Committee had concurred in Oneida's decision to pursue its claims against the bank and that an application had been made to the bankruptcy court for a plan amendment that would provide for creditor participation in any recovery.

7. Oneida's disclosure statement charged the bank with:

> unilaterally with[drawing] Four Hundred Fifty Thousand Dollars ($450,000) from the Debtor's operating

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ing announced its displeasure at the outset, Oneida actively preserved its right to file claims. When the bank sought a general release in connection with the order establishing the extent and validity of its lien, for instance, Oneida's counsel wrote:

> While we would have no objection to an amendment of the Order to, in effect, delete the handwritten portion of the Order which was included per Judge DeVito's direction, the Order proposed by you constitutes an omnibus release pertaining to the matters far beyond the issue of service charges. Unless the Order is modified to pertain only to the issue of service charges, the matter cannot be resolved . . .

App. at 422. Oneida successfully secured exclusion of the release. Thereafter, Oneida's insistence on preserving any claims it might have never wavered, and culminated in Article XII of the reorganization plan itself:

> All claims and causes of action in favor of [Oneida] not expressly released or terminated in accordance with the Plan are hereby preserved and may be prosecuted by [Oneida] or the Creditors' Committee after entry of the Confirmation Order.

App. at 146.

Thus, Oneida never assumed a position which its current actions repudiate. *Compare Scarano v. Central R. Co.*

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> account to be applied towards satisfaction of the Dorn's settlement

and claimed that

> Said overdraft caused an immediate overdraft in the Debtor's account, which became a chronic situation until the filing of the bankruptcy proceedings.

App. at 109.

*of New Jersey*, 203 F.2d 510, 513 (3d Cir. 1953); *In re Galerie Des Monnaies of Geneva Ltd.*, 55 B.R. 253 (Bankr. S.D. N.Y. 1985), *aff'd* 62 B.R. 224 (S.D. N.Y. 1986) (debtor had affirmatively stated a belief it did not have preference actions, and would have been the only beneficiary of actions ultimately brought after bankruptcy). Nor has the bank pointed to any persuasive evidence that it was prejudiced by anything Oneida did or did not do during the bankruptcy proceeding.[8]

In sum, equitable and judicial estoppel are extraordinary remedies to be invoked when a party's inconsistent behavior will otherwise result in a miscarriage of justice. Oneida's behavior was neither inconsistent nor inequitable. Accordingly, I believe that the court should not have applied estoppel doctrines to this case.

III.

For the foregoing reasons, I would reverse the judgment of the district court.

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8. The court maintains that, had the bank known about Oneida's claims, it might not have entered into a stipulation as to the extent and validity of its lien, or voted for confirmation. I find it difficult to believe the bank was prejudiced in these respects, when undisputed evidence indicates that the bank was essentially paid in full by Oneida's plan. The bank's consent to the use of some of its cash collateral came prior to the filing of Oneida's statements of assets and liabilities and its disclosure statement and could not have been influenced thereby.

A True Copy:

Teste:

*Clerk of the United States Court of Appeals*
*for the Third Circuit*

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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No. 87-5525

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ONEIDA MOTOR FREIGHT, INC., et al.,
*Appellant*

vs.

UNITED JERSEY BANK, et al.

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SUR PETITION FOR REHEARING
(Filed July 1, 1988)

Present: GIBBONS, *Chief Judge,* SEITZ, HIGGINBOTHAM, SLOVITER, BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, and COWEN, *Circuit Judges.*

The petition for rehearing filed by appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

BY THE COURT,

/s/ Carol Los Mansmann
Circuit Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

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| ONEIDA MOTOR FREIGHT, | ) | |
| | ) | Civil Action |
| Plaintiff, | ) | No. 87-1440 |
| | ) | |
| v. | ) | OPINION |
| | ) | |
| UNITED JERSEY BANK, | ) | (Filed July 6, 1987) |
| | ) | |
| Defendant. | ) | |

SAROKIN, District Judge.

In this action by a bankrupt trucking company against its bank for breach of contract and misrepresentation, defendant United Jersey Bank moves to dismiss the complaint.

BACKGROUND

Plaintiff Oneida Motor Freight, Inc. (Oneida), a New York corporation founded in 1935, engaged in interstate trucking in the northeastern United States. On March 28, 1984, Oneida and defendant United Jersey Bank (the Bank) entered into two agreements: a Revolving Credit Agreement, whereby the Bank would extend up to $5 million in credit to Oneida through loans and letters of credit; and an Accounts Receivable Loan and Security Agreement, whereby the Bank would lend Oneida a percentage of Oneida's accounts receivable, with the Bank obtaining a security interest in Oneida's accounts, equipment, and inventory.

In February 1985, Oneida settled a dispute with Dorn's Transportation, a company that Oneida was ac-

quiring. Oneida, to pay its part of the settlement, called upon the Bank to pay certain outstanding letters of credit. According to Oneida, the Bank unilaterally withdrew the necessary funds from Oneida's operating accounts, rather than charging against the letters of credit as had been previously agreed. Thereafter, Oneida's account became habitually overdrawn and experienced deposits of uncollected funds. The Bank, however, repeatedly honored Oneida's overdrafts.

On July 2, 1985, the Bank requested that third-party defendant Donald Singleton, the owner of Oneida, personally guarantee Oneida's debt. Mr. Singleton refused. On July 5, 1985, the Bank ceased honoring Oneida's checks, including over $1 million in recently issued payroll checks. According to Oneida, the dishonor of these checks compelled it to file a Chapter 11 bankruptcy petition on July 10, 1985. Oneida, in a schedule filed with the petition, acknowledged an undisputed, liquidated, and non-contingent debt to the Bank of $7.7 million. Oneida immediately ceased operations and proceeded with a liquidation.

On July 11, 1985, the Bank filed a motion for relief from the automatic stay, to enforce its security interest, and for other relief. The Bankruptcy Court, by orders dated January 14 and March 3, 1986, established the extent and validity of the Bank's lien at over $7.6 million.

Also on July 11, 1985, Oneida moved for authority to use cash collateral of the Bank. On September 30, 1985, the Bankruptcy Court entered a Stipulation and Order confirming the parties' settlement of this application. The order provided for Oneida's use of up to $1.5 million in the Bank's cash collateral and the Bank's release of cer-

tain liens, expressly conditioned upon Oneida's payment by October 3, 1985 of over $6.6 million due to the Bank.

On May 12, 1986, Oneida filed an Amended Joint Plan of Reorganization under Chapter 11 in the Bankruptcy Court. The plan includes the Bank's deficiency claim, as a Class 9 creditor, for over $270,000. No objection to this claim has been filed. On August 14, 1986, the Bankruptcy Court entered an order confirming the amended joint plan.

On March 11, 1987, Oneida filed a complaint against the Bank in the Superior Court of New Jersey, Law Division, Bergen County, alleging breach of the financing agreements and misrepresentation surrounding the Bank's failure to honor Oneida's July 1985 checks. On April 15, 1987, the Bank filed a third-party complaint against Donald Singleton.[1] On April 20, 1987, the Bank removed this matter to this court pursuant to 28 U.S.C. § 1452(a).

The Bank moves to dismiss the complaint under Rules 12(b)(6) and 12(c).

DISCUSSION

The Bank's primary argument for dismissal,[2] though

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1. The court, by order dated June 24, 1987, granted Singleton's motion to dismiss the third-party complaint.

2. The Bank moves pursuant to Rules 12(b)(6) and 12(c). Oneida contends that the motion is properly understood as a Rule 56 motion for summary judgment because the Bank relies on materials outside the pleadings, namely pleadings and orders from the bankruptcy court. The court finds the dispute irrelevant. Before the court is a legal question regarding the preclusive effect of the bankruptcy proceedings. The Bank may prevail on this motion if the current record supports a finding of preclusion. No discovery is necessary for Oneida to defend against the Bank's *res judicata* arguments.

made in several forms is that the prior proceedings of the bankruptcy court preclude Oneida's current claims.

At first blush, the determination of which law governs this issue appears straightforward—a federal court applies federal rules to determine the preclusive effect of a prior federal question judgment of another federal court. *See Seven Elves, Inc. v. Eskenazi,* 704 F.2d 241, 243 n.2 (5th Cir. 1983); C. Wright, A. Miller & E. Cooper, *Federal Practice & Procedure* § 4468 (1981 & Supp. 1986).

In applying this rule, however two questions arise. First, was the original judgment of the bankruptcy court a "federal question" judgment? Yes, answers the court. Though the bankruptcy court had to make some subsidiary state law determinations (such as the validity of the Bank's security interests), the court's orders were in the context of a Chapter 11 reorganization governed by federal bankruptcy law. Second, is it relevant that the current federal action, removed from state court, involves adjudication solely of state law claims? No, answers the court. Even if this action had not been removed, the state court would be bound by federal law in determining the preclusive effect of the bankruptcy court's federal question rulings—thus, *Erie* concerns of inconsistent state and federal results are not present.

The court, therefore, applies federal rules of preclusion to the Bank's motion.

As stated above, the Bank's principal contention is that the prior bankruptcy proceedings preclude Oneida's current claims. The "claim preclusion" branch of the *res judicata* doctrine, in part, bars relitigation of claims actually litigated in a prior proceeding. In this matter, how-

ever, plaintiff's state law claims have never been actually litigated—they were neither presented nor adjudicated in any bankruptcy proceeding.[3] The *res judicata* doctrine, however, also precludes any claim which might have been included in that action. *See, e.g., Donegal Steel Foundry Co. v. Accurate Prods. Co.*, 516 F.2d 583, 587 (3d Cir. 1975); *Recchion v. Kirby*, 637 F. Supp. 284, 286 (W.D. Pa. 1985). The Bank's preclusion argument, in essence, is that Oneida's failure to raise its contract and misrepresentation claims in the bankruptcy proceedings bars the current suit.[4]

The Bank, to prevail on its res judicata argument, must demonstrate 1) that the bankruptcy proceedings constitute a final judgment on the merits; 2) that these proceedings involve the same parties as the current suit; and 3) that the current suit is based on the same "cause of action" as that adjudicated in the bankruptcy court. *See Purter v. Heckler*, 771 F. 2d 682, 690 (3d Cir. 1985); *United States v. Athlone Inds.*, 746 F. 2d 977, 983 (3d Cir. 1984).

Under this framework, the Bank's argument hinges on whether plaintiff's current claims and the claims pre-

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3. Therefore, the Bank's collateral estoppel argument fails. The issues involved in plaintiff's claims were not actually litigated in the bankruptcy court, as would be required for collateral estoppel (or "issue preclusion") to apply. *See, e.g., Haize v. Hanover Ins. Co.*, 536 F.2d 576, 579 (3d Cir. 1976).

4. That the Bank's motion turns on the question of which claims should have been litigated in a prior federal bankruptcy proceeding supports the court's ruling that federal rules of preclusion apply to this motion. Thus, the court does not apply the New Jersey "entire controversy" doctrine.

sented to the bankruptcy court are part of the same "cause of action."[5] The Third Circuit has explained its approach to this elusive concept.

> Although we declined to adopt *one* specific legal theory in [*Davis v. United States Steel Supply*, 688 F. 2d 166 (3d Cir. 1982) (en banc), *cert. denied*, 460 U.S. 1014 (1983)], we indicated a predisposition towards taking a broad view of what constitutes identity of causes of action—"an essential similarity of the underlying events giving rise to the various legal claims." We therefore do not adhere to any mechanical application of a single test but instead focus on the central purpose of the doctrine of res judicata. We are thus keeping with "[t]he present trend . . . in the direction of requiring that a plaintiff present in one suit all the claims for relief that he may have arising out of the same transaction or occurrence."

*United States v. Athlone Inds.*, 746 F. 2d 977, 984 (3d Cir. 1984) (citing 1B J. Moore & J. Wicker, *Moore's Federal Practice* ¶0.410[1], at 359 (2d ed. 1983)). Restatement (Second) of Judgments § 24(1) represents the "present trend," and states that a judgment in a prior action extinguishes any claims "with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose."

The court, applying this broad transactional view, finds that Oneida's current claims and the claims presented in the bankruptcy court, are parts of the same "cause of action." Oneida contends that the claims in-

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5. There is no dispute that the bankruptcy orders constitute final judgments on the merits in a prior suit between the same parties.

volve different transactions—its current claims for breach of contract and misrepresentation focus on the Bank's conduct in failing to honor overdraft checks, while the bankruptcy proceedings centered on the creation of the bank's security interest and the validity of that interest. The court finds, however, that at the least, the claims arise from "a series of connected transactions," thus satisfying the Restatement test. *See Southmark Properties v. Charles House Corp.*, 742 F. 2d 862, 871 (5th Cir. 1984) (applying the Restatement position in a bankruptcy context).

Oneida contends, though, that *res judicata* cannot bar its current claims because it had no opportunity to raise those claims in the bankruptcy proceedings.

As an initial matter, the bankruptcy court would have had subject matter jurisdiction to hear Oneida's state law claims. A bankruptcy court may hear "all core proceedings arising under title 11, or arising in a case under title 11." 28 U.S.C. § 157 (b)(1). "Core proceedings" specifically include "counterclaims by the estate against persons filing claims against the estate." 28 U.S.C. § 157(b)(2)(C).

Oneida argues, however, that it could not have raised, or was not obligated to have raised, its claims in any of the proceedings which resulted in orders of the bankruptcy court. With respect to the August 14, 1986 order confirming the amended joint plan of reorganization, plaintiff contends that the "Reservation of Claims" provision[6]

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6. Article XII of the amended plan reads:

> All claims and causes of action in favor of the Debtor and Debtor-in-Possession not expressly re-

(Continued on following page)

makes plain that it had no obligation to raise its fraud claims in the confirmation proceedings. With respect to the proceedings resulting in the orders establishing the validity of the Bank's lien,[7] Oneida contends that a counterclaim could not have been properly brought such proceedings. Oneida's position is that the Bank initiated these proceedings as a motion for relief from the automatic stay under § 362; that such a motion is a "contested matter" under Bankruptcy Rule 9014; that Rule 7013, dealing with compulsory counterclaims, is not applicable in such a proceeding; and that, even if counterclaims are permissible, "the defensive and informal nature of [§ 362] stay litigation should . . . preclude the formal assertion of counterclaims." 2 Collier on Bankruptcy ¶362.08[3], at 362-67 (15th ed. 1986).[8]

Oneida's contentions, even if accepted, do not rebut the Bank's *res judicata* argument. As stated above, that doctrine requires that "a plaintiff present in one suit all the claims for relief" that he may have arising from a transaction. *See United States v. Athlone*, 746 F. 2d 977 (3d Cir. 1984) (citation omitted). Though Oneida is not the

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leased or terminated in accordance with the Plan are hereby preserved and may be prosecuted by the Debtor or the Creditor's Committee after entry of the Confirmation Order.

7. These are the orders of January 14 and March 3, 1986, and the September 30, 1985 stipulation and order of settlement in connection with Oneida's application to use cash collateral.

8. The Bank contends that its application, which also sought a determination of the validity of its lien, is properly considered as an "adversary proceeding" under Rule 7001, in which Oneida would have had the opportunity and obligation to bring its counterclaims under Rule 7013.

"plaintiff" in all the proceedings involved here,[9] Oneida was under an obligation—to the court, to the Bank, and to its creditors—to raise its claims against the Bank in the bankruptcy proceedings.[10]

Oneida does not and cannot contend that it had no opportunity during the bankruptcy proceedings to advise the court or the Bank of its intent to bring these claims. The bankruptcy court, if so advised, could have determined the proper procedural mechanism for Oneida to puruse its claims. The Bank, if so advised, could have (and represented at argument that it would have) objected to the confirmation of the reorganization plan. Under these circumstances, Oneida's failure violates a fundamental principle of current preclusion doctrine—that courts and parties should be able to rely on a final judgment as the end of all litigation with respect to a particular transaction or occurrence.

Oneida's current claims against the Bank arise from the same transaction, or series of connected transactions, as was the subject of extensive prior bankruptcy proceedings between these parties. Oneida's failure to bring to the court's attention claims against the Bank, of which Oneida was aware before the bankruptcy proceedings commenced, bars its current action.

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9. For example, the Bank moved for relief from the stay and for a determination of the validity of its lien; Oneida, if it had raised its claim, would have done so defensively as a counterclaim.

10. Oneida, at argument, stated that it advised the creditors', at their first meeting, of its bad faith and contract claims against the Bank. The court holds that Oneida, by such action, cannot be said to have raised its claims in the bankruptcy proceeding.

*CONCLUSION*

A debtor in a bankruptcy proceeding owes a special duty of disclosure to the court and creditors. Decisions are made by both predicated upon such disclosures by the debtor. Even absent a specific duty to file a claim or counterclaim, it is difficult to envision that a debtor can decline to reveal the existence of a claim and the intent to pursue it, particularly when it asserted against a named creditor.

The court grants defendant United Jersey Bank's motion to dismiss plaintiff's complaint.

/s/ H. Lee Sarokin
H. LEE SAROKIN, U.S.D.J.

Date: July 6, 1987

Original to Clerk, U.S. District Court

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

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| ONEIDA MOTOR FREIGHT, | ) | Civil Action |
| | ) | No. 87-1440 |
| Plaintiff, | ) | |
| v. | ) | ORDER |
| | ) | |
| UNITED JERSEY BANK, | ) | |
| | ) | (Filed July 6, 1987) |
| Defendant. | ) | |

This matter having been opened to the court on the defendant's motion to dismiss the complaint; and the court having considered the written submissions and heard oral argument; and for the reasons expressed in the accompanying opinion,

IT IS this 6 day of July, 1987, hereby

ORDERED that defendant's motion to dismiss plaintiff's complaint is granted, and it is further

ORDERED that plaintiff's complaint is dismissed with prejudice.

/s/ H. Lee Sarokin
H. LEE SAROKIN, U.S.D.J.